In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 677

THE A. P. SMITH MANUFACTURING COMPANY,
PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

In 1954 and 1955, petitioner, a manufacturing corporation, made voluntary contributions of stock (shares of other corporations) to a pension trust created for the benefit of its employees. It treated the contributions as payments of business expenses on its 1954 and 1955 income tax returns, deducting from its gross income the fair market value of the stock as of the date of each transfer to the trust.[1]

[1] Section 404(a) of the Internal Revenue Code of 1954 permits an employer to deduct contributions to certain employees'

The Commissioner allowed the deductions, but determined that petitioner realized gain to the extent that the fair market value of the stock transferred exceeded its adjusted basis. The gain thus calculated, amounted to approximately $53,000 for 1954 and $34,000 for 1955.[2] Petitioner paid the deficiencies and brought this suit after rejection of its refund claims. The Court of Claims upheld the Commissioner's determination. (R. 333, 340, 342, 343-344, 346-347.)

The decision of the Court of Claims is correct. There is no conflict of decisions or other circumstance warranting further review.

1. The stock transfers were taxable "disposition[s] of property," within the purview of 1954 Code § 1001(a), because the stock was transferred in payment of an ordinary and necessary business expense. See *United States* v. *General Shoe Corp.*, 282 F. 2d 9 (C.A. 6), certiorari denied, 365 U.S. 843; *International Freighting Corp.* v. *Commissioner*, 135 F. 2d 310 (C.A. 2); *Montana Power Co.* v. *United States*, 171 F. Supp. 943 (Ct. Cl.). Petitioner, although under no legal obligation, transferred the stock to the employee pension trust in response to conditions in the labor market. These expenditures were intended

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pension plans (and other similar plans) if the contributions qualify as ordinary and necessary trade or business expenses under Code § 162 (Pet. 24-25).

[2] The Commissioner originally asserted that the gain constituted ordinary income, but later conceded in court that the gain was taxable as capital gain (R. 333).

to have an effect similar to the payment of salaries, bonuses, and other more direct forms of compensation. (See R. 342-343, Findings 4(i), 5.) Like the payment of bonuses and salaries, the stock transfers reduced the risk of losing employees to higher paying competitors and were a means of preventing labor disputes. Since petitioner's dispositions of the securities resulted in an economic benefit to it, they were taxable events.

In *United States* v. *Davis*, 370 U.S. 65, the taxpayer had transferred appreciated property to his former wife incident to a divorce. The Court held that this "transaction was * * * a taxable event" (370 U.S. at 71) and that, in the absence of contrary evidence, it must be assumed that the economic benefit to the taxpayer (from his ex-wife's release of her marital rights) was equal to the value of the property which he transferred. In this regard the Court said (pp. 72-73):

> once it is recognized that the transfer was a taxable event, it is more consistent with the general purpose and scheme of the taxing statutes to make a rough approximation of the gain realized thereby than to ignore altogether its tax consequences. * * *

It is especially appropriate to assume that a taxpayer received full value for his expenditures in a case, like the instant one, which involves carefully considered business arrangements. It is clear that petitioner would have been liable for the capital gain tax here in controversy, if, instead of transferring

the stock to the pension trust in kind, it had sold the stock and transferred the proceeds to the trustee.

2. There is no conflict of decisions. The Sixth and Second Circuits have also held that a taxpayer realizes gain when it transfers appreciated property to a pension trust or uses it to pay employee bonuses. *United States* v. *General Shoe Corporation*, 282 F. 2d 9 (C.A. 6), certiorari denied, 365 U.S. 843 (pension trust); *International Freighting Corp.* v. *Commissioner*, 135 F. 2d 310 (C.A. 2) (employee bonus awards). This Court cited both of those decisions with approval in *United States* v. *Davis*, *supra*, 370 U.S. at 72.

Petitioner argues that the instant decision conflicts with *Lincoln Electric Company* v. *Commissioner*, 162 F. 2d 379 (C.A. 6). In that case the Sixth Circuit held that the taxpayer's contributions to an employee pension plan qualified for a tax deduction as ordinary and necessary business expenses whether or not they could be labelled compensation for services rendered. The instant Court of Claims decision is not in conflict with *Lincoln Electric*, since here the Commissioner permitted the deductions and the only question is whether the petitioner realized gain to the extent of the appreciation in the value of the contributed property.[3]

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[3] Petitioner also cites cases holding that a transfer of appreciated property by gift does not constitute a taxable event (Pet. 17-18). These cases are not relevant here where petitioner did not give the appreciated securities away, but obtained an economic benefit by transferring them "for business reasons" in payment of ordinary and necessary business expenses (Pet. 18).

3. Nor is there merit in petitioner's argument, in reliance upon *Burnet* v. *Logan*, 283 U.S. 404, that the transfers to the pension trust were not "closed" transactions. In *Burnet* v. *Logan* this Court held that the recognition of gain should be postponed where a taxpayer transferred stock in exchange for the right to receive "future money payments wholly contingent upon facts and circumstances not possible to foretell with anything like fair certainty" (p. 413). Therefore, the Court held that the "transaction was not a closed one" (*ibid.*) and that the taxpayer should wait until the payments were received, and then, after recovering her capital investment, report the additional payments as gain. In this case, however, as in *United States* v. *Davis*, *supra*, the taxpayer was not entitled to receive any later payments in consideration for the transfer of the appreciated property. Just as the taxpayer in *Davis* realized gain when he satisfied his marital obligations with appreciated property, petitioner realized gain when it paid business expenses with appreciated property. Nothing more was needed to make the transactions more certain or final.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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